

FDIC State Profile

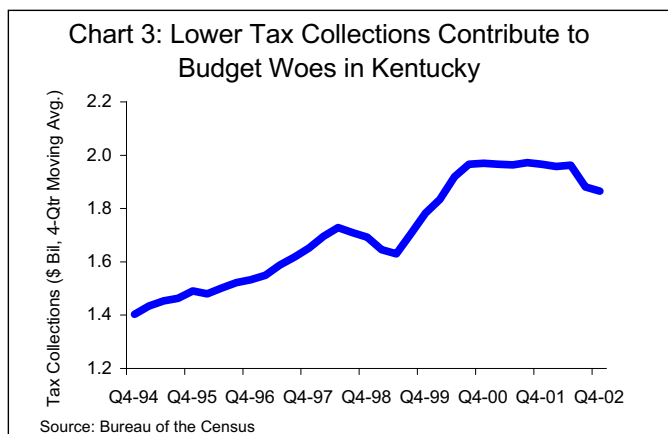
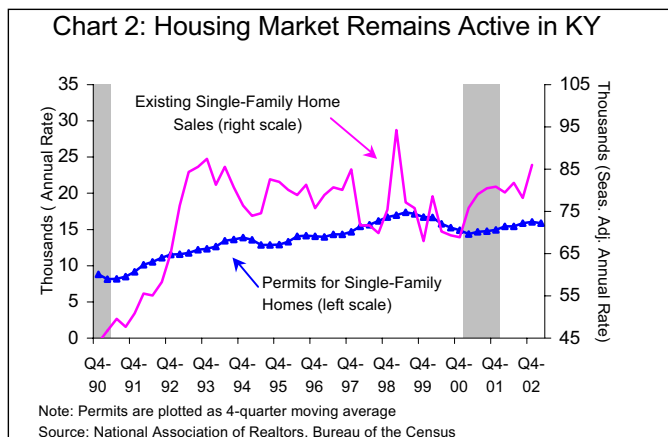
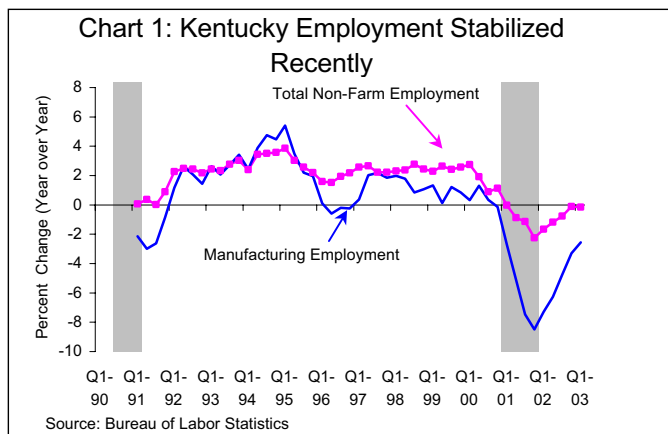
SUMMER 2003

Kentucky

Kentucky's economy expanded modestly in 2002.

- Employment in Kentucky stabilized in the past year, as recovery from the 2001 recession continued at a modest pace. Kentucky's employment level in first-quarter 2003 matched that of a year earlier, following losses in the previous eight quarters (see **Chart 1**).
- Not all sectors participated equally, however. Manufacturing jobs in first-quarter 2003 declined for the tenth consecutive quarter, but the pace of loss slowed considerably as 2002 progressed (see **Chart 1**). Losses also occurred in sectors involved with natural resources and mining, trade, transportation, and utilities. Offsetting growth was concentrated among providers of educational and health services, leisure and hospitality services, and professional and business services.
- Housing market activity in Kentucky remained high through early 2003, as reflected by the large number of construction permits for single-family homes and re-sales of existing homes (see **Chart 2**). The pace of price appreciation slowed to around 3.5 percent in the year ending fourth-quarter 2002, compared with the 4- to 5-percent range observed during the previous seven years.¹
- The end of active fighting in Iraq seems to be boosting consumer confidence, which enhances the outlook for stronger economic activity in general. In the Hopkinsville area, however, the absence of 20,000 military personnel from Fort Campbell may dampen local housing and retail activity in the short term. Government programs tailored to ease financial burdens on deployed troops and reservists may mitigate the potential adverse impact on consumer and mortgage loans to area residents.
- National demand for motor vehicles and appliances produced in the state is not expected to be a source of near-term strength, as sales of these big-ticket items are expected to rise modestly, at best.
- Government budget constraints are an issue in most states, and Kentucky is no exception, as tax collections weakened in 2002 (see **Chart 3**). Some of the stimulus from federal tax cuts and higher military spending likely will be offset

¹ Appreciation data reflect average price changes in repeat sales or refinancings on the same properties, based on transactions involving conforming, conventional mortgages purchased or securitized by Fannie Mae or Freddie Mac.



by higher fees and taxes imposed by state and local governments, along with cutbacks in their spending and employment levels. The impact of such reductions will be uneven, reflecting the varying importance of affected sectors (for example, healthcare, education, infrastructure construction) across metropolitan areas and smaller localities.

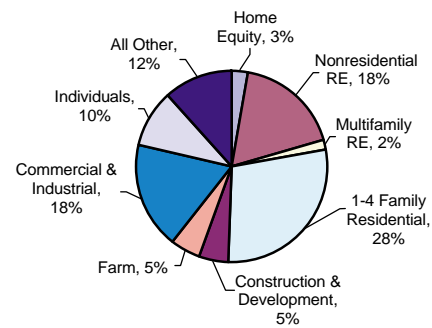
Conditions at Kentucky's insured financial institutions changed little in 2002

- Eighty-eight percent of Kentucky's 248 insured banks and thrifts at year-end 2002 were established community institutions—banks and thrifts with assets under \$1 billion that are neither de novo nor specialty institutions. Five percent of the state's banks and thrifts are de novo institutions, less than three years old, and three percent have assets between \$1 and \$10 billion.
- As expected in a state dominated by community institutions, one- to four-family mortgages comprise the largest share (29 percent) of loan portfolios (see **Chart 4**). Loans to businesses—commercial and industrial loans for operating purposes and commercial real estate loans—rank next in importance, with shares at year-end 2002 of 18 percent each.
- Asset quality at institutions headquartered in Kentucky held about steady during 2002. However, median past-due and nonaccrual loans in December 2002 and December 2001 remained 22 to 60 basis points higher than for the same reporting periods from 1998 through 2000 (see Page 3, Kentucky at a Glance), probably reflecting the impact of the 2001 recession on some borrowers' repayment abilities.
- On the earnings front, the median net interest margin (NIM) of Kentucky institutions edged up to 4.04 percent at year-end 2002, slightly higher than the decade's low at year-end 2001. As market interest rates fell in the past few years to the lowest levels in several decades, insured institutions' cost of funding earning assets also declined. However, their yield on earning assets fell a bit faster, thus squeezing the NIM (see **Charts 5 and 6**).

Issues to Watch

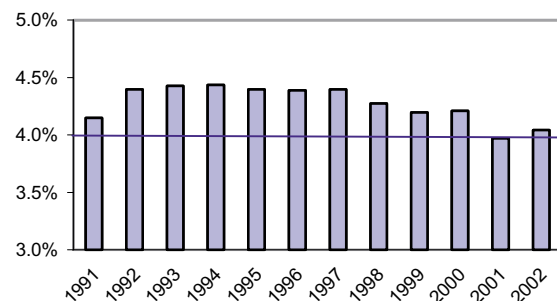
- The state and national economies appear to be on track for continuing, moderate expansion, but the recovery is vulnerable to economic, financial, and geopolitical shocks that could arise at home or abroad. Lackluster growth nationwide would temper the potential for improvement in the state's manufacturing and distribution industries.
- Banks and thrifts that rely on deposits from municipalities as a funding source or hold municipal securities in their portfolios may need to monitor their

Chart 4: Loan Composition at KY Banks and Thrifts



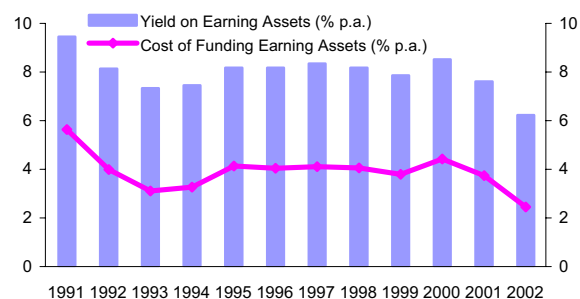
Source: Bank and Thrift Call Reports

Chart 5: Median Net Interest Margin Hovers Around 4 Percent at KY Institutions



Source: Bank and Thrift Call Reports

Chart 6: Lower Yield and Cost of Funding Earning Assets at KY Institutions Reflect Market Conditions



Source: Bank and Thrift Call Reports

strategies and risk tolerances in the current environment, as debt ratings are being downgraded for some state and local government units.

- Having fared the 2001 recession fairly well, banks and thrifts face loan demand that likely will remain sluggish until economic growth strengthens noticeably. The past year's governance, fraud, and technology breaches (nationwide) highlight the need for monitoring internal controls and routines, internally at banks and thrifts as well as among their contractors and customers.

Kentucky at a Glance

General Information	Dec-02	Dec-01	Dec-00	Dec-99	Dec-98
Institutions (#)	248	258	267	286	301
Total Assets (in thousands)	55,137,435	58,655,153	55,652,165	54,756,788	55,846,376
New Institutions (# < 3 years)	12	16	16	18	22
New Institutions (# < 9 years)	40	41	41	38	39
Capital	Dec-02	Dec-01	Dec-00	Dec-99	Dec-98
Tier 1 Leverage (median)	9.18	9.32	9.47	9.45	9.51
Asset Quality	Dec-02	Dec-01	Dec-00	Dec-99	Dec-98
Past-Due and Nonaccrual (median %)	2.44%	2.45%	2.22%	1.84%	2.12%
Past-Due and Nonaccrual > = 5%	39	38	27	20	33
ALLL/Total Loans (median %)	1.26%	1.20%	1.16%	1.17%	1.20%
ALLL/Noncurrent Loans (median multiple)	1.54	1.52	1.63	1.83	1.83
Net Loan Losses/Loans (aggregate)	0.56%	0.52%	0.36%	0.38%	0.36%
Earnings	Dec-02	Dec-01	Dec-00	Dec-99	Dec-98
Unprofitable Institutions (#)	21	27	23	15	20
Percent Unprofitable	8.5%	10.5%	8.6%	5.2%	6.6%
Return on Assets (median %)	1.07	1.02	1.12	1.19	1.22
25th Percentile	0.70	0.56	0.72	0.80	0.80
Net Interest Margin (median %)	4.04%	3.97%	4.21%	4.19%	4.27%
Yield on Earning Assets (median)	6.79%	7.98%	8.44%	8.01%	8.25%
Cost of Funding Earning Assets (median)	2.76%	3.98%	4.22%	3.81%	4.03%
Provisions to Avg. Assets (median)	0.23%	0.22%	0.19%	0.18%	0.15%
Noninterest Income to Avg. Assets (median)	0.68%	0.65%	0.60%	0.60%	0.61%
Overhead to Avg. Assets (median)	2.86%	2.86%	2.86%	2.76%	2.81%
Liquidity/Sensitivity	Dec-02	Dec-01	Dec-00	Dec-99	Dec-98
Loans to Deposits (median %)	80.07%	82.22%	83.79%	84.27%	79.18%
Loans to Assets (median %)	65.98%	66.08%	68.10%	67.71%	65.01%
Brokered Deposits (# of Institutions)	36	39	41	43	46
Bro. Deps./Assets (median for above inst.)	1.21%	1.06%	1.02%	1.17%	1.24%
Noncore Funding to Assets (median)	19.60%	20.24%	19.82%	19.13%	16.33%
Core Funding to Assets (median)	68.35%	68.40%	67.96%	70.00%	71.59%
Bank Class	Dec-02	Dec-01	Dec-00	Dec-99	Dec-98
State Nonmember	161	167	170	182	192
National	52	52	52	57	61
State Member	8	11	11	9	8
S&L	10	10	11	11	14
Savings Bank	17	18	23	27	26
Mutually Insured	0	0	0	0	0
MSA Distribution	# of Inst.	Assets (\$thous)	% Inst.	% Assets	
No MSA	176	22,696,761	71.0%	41.2%	
Lexington KY	23	4,364,116	9.3%	7.9%	
Louisville KY-IN	17	21,999,932	6.9%	39.9%	
Cincinnati OH-KY-IN PMSA	15	3,256,347	6.0%	5.9%	
Huntington-Ashland WV-KY-OH	9	1,358,326	3.6%	2.5%	
Owensboro KY	3	570,312	1.2%	1.0%	
Clarksville-Hopkinsville TN-KY	3	696,315	1.2%	1.3%	
Evansville-Henderson IN-KY	2	195,326	0.8%	0.4%	